establishing rates in arbitrations and in reviewing BOC statements of generally available terms and conditions.

In regard to paragraph 126, the Washington UTC agrees with the NPRM's definition of Long Run Incremental Cost. However, LRIC differs substantially from the proper definition of Total Service LRIC which should encompass the concept that TSLRIC costs are costs which go away if the service goes away. TSLRIC costs are properly estimated based upon the assumption that not only are the investments assumed to be forward looking and the latest technology, but also that they are assumed to represent the cost of producing a service in the most efficient manner using the latest technology. Thus shared, common, and joint costs do not properly belong in a definition of TSLRIC.[5] Of particular concern is the proper treatment of excess, or spare, capacity, which should not be included in the calculation of estimated TSLRIC, if the excess capacity is not specifically designed to permit proper network development. In other words, there are three kinds of excess capacity. There is administrative spare which properly belongs in the estimate of TSLRIC, and then there is spare created by breakage, and finally there is spare which is plant held for future use. Only administrative spare properly belongs in any estimate of TSLRIC. To address this concern, the Washington UTC has ordered TSLRIC studies should be developed based upon

[5] Loop costs are considered shared costs because they would not go away if any one network service disappeared.

objective fill factors, and not upon average fill. Therefore, proper TSLRIC studies estimate costs at what they should be under an efficiency assumption, not what they actually are in a monopoly environment today.

In paragraph 128, the NPRM seeks comments on approaches taken by states with respect to pricing principles, and costing methodologies and whether incumbent LECs have been ordered to offer unbundled network elements at rates based on LRIC. The Washington UTC has found that an interconnection rate needs to reflect how costs are caused. Charging a usage-based rate to recover costs that are primarily fixed in nature is likely to discriminate against certain groups of customers, distort incentives to enter the competitive market, discourage economic efficiency in the design of networks, and prove unsustainable under competition.

Cost studies can amount to the proverbial "black box", which limits the ability of other parties to review and to independently test and verify the assumptions in the company's cost studies. The Washington UTC has ordered U S West in future cost studies to permit open access to the company's cost methodology, input data, assumptions, and cost modeling recommended there. These filings should include the full and complete set of work papers and supporting source documents, to be filed simultaneously with the results of the study.

Incumbent companies should recognize that inability to produce respectable, auditable, "checkable" cost studies is detrimental to their own self interest. They must do better in this regard if they expect to succeed in persuading a regulatory body of the rightness of their positions.

The Washington UTC has directed that the starting point for such interconnection pricing proposals should be TSLRIC. Economically efficient purchasing decisions should be based on the underlying TSLRIC, because that is the closest estimate to the theoritical economic concept of long run marginal cost.

In paragraph 129, the NPRM seeks comment on the problem with basing rates on LRIC alone if there are significant joint and common costs among network elements, even if such costs are determined on a forward-looking basis. The Washington UTC recognizes the problem as well, and has made substantial strides in determining the magnitude of joint and common costs of U S West's network.[6] It has been argued that interconnection rates should be set at TSLRIC because an incumbent LEC should not be permitted to earn profits from services it provides to competitors. The Washington UTC is not prepared to accept that argument, though we do not reject it at this point. To illustrate that it may be appropriate for rates to exceed TSLRIC, consider the extreme case where every customer is served by a new entrant: Would the backbone network still be provided by the

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[6] Docket UT-950200.

incumbent LEC? Would rates based on the TSLRIC of interconnection be sufficient to pay the costs of that network? The question, viewed from another perspective, is: Would the new entrant compete with the incumbent LEC in every aspect and component of its service? Or, does there exist a core network integration function that new entrants cannot be expected to provide? If so, the cost of that function would appear to be one that should be recovered in an interconnection rate that exceeds TSLRIC.

In paragraph 132, the NPRM seeks comment on a transitional pricing mechanism during an interim time period. One possible approach the FCC describes would be to require that during an interim period, rates be set at short-run marginal cost. The FCC postulates that such an approach might give incumbent LECs an incentive to reach agreement more rapidly. The Washington UTC agrees with pursuing such an interim or transitional approach with regard to pricing of interconnection services, with the *caveat* that specific price levels should still be developed at the state level for intrastate services.

In paragraphs 134 through 142, the NPRM seeks comments on the benefits and options associated with setting ceiling rates through some form of proxy mechanism rather than specifying a particular pricing methodology. Generally, the Washington UTC is not opposed to rate ceilings, provided that states, through their pricing authority, have the ability to order lower rates based on their findings.

In the recent U S West case, the Washington UTC noted the absence of a record on appropriate price ceilings. The record showed that incremental costs provide a theoretical price floor for each service such that if rates are set below that amount, other firms could be prevented from entering the market. Conversely, the price ceiling would be defined as the costs that a firm would incur if it were to provide a particular service on a stand-alone basis.[7]

As for proxies, the Washington UTC, after considerable review of the various U S West supplied proprietary cost studies, accepted the Hatfield Model as the most reasonable and accurate measure of incremental costs for the services under review. The Hatfield Model uses publicly-available cost information from U S West and other sources, and it incoporates elements of the Benchmark Cost Model. Claims by U S West that the model is inaccurate were not backed up by any evidence. On the contrary, our comparison of the Hatfield Model's numbers with confidential numbers from U S West using our underlying assumptions and inputs showed that if the model erred, it erred on the high side, mostly through the inclusion of an overhead factor. If a proxy must be used, the Washington UTC would support the Hatfield model given the usual caveat that states have the right to adjust the model to meet their unique needs.

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[7] Docket No. UT-950200.

The Washington UTC is particularly nervous about any suggestion that it base rates going forward on existing toll access rates as is suggested in paragraph 139. That structure is in serious need of reform. To base rates going forward on a structure designed in the past is akin to building a modern home on a crumbling foundation.

In the local interconnection proceeding in Washington, U S West filed a local interconnection service tariff proposal based on its switched access tariff, and created a new access rate element for local interconnection called an "interim universal service charge" ("I-USC"). The I-USC was the same amount as the carrier common line charge proposed to be levied on interexchange carrier switched access customers, $0.0228/local switching minute. Thus, for local traffic delivered to U S West for termination, a competitive new LEC would be assessed a local switching charge of $0.01/minute, an interim universal service charge (I-USC) of $0.0228/minute, and transport charges for transport services used. The local interconnection service proposal by U S West would require the establishment of a formal tracking, measurement, and billing mechanism for local call termination.

One of the arguments U S West offered in favor of this structure was that it would move local access in line with toll access. The Washington UTC, in rejecting this structure, did not foreclose the option of some day bringing toll and local access rate structures into uniformity but firmly rejected designing local access rates along the lines of existing toll access rates,

The switched access price structure for interexchange access today is usage sensitive. The Washington UTC has found that no incumbent LEC has the capability of measuring terminating local interconnection minutes today; this means that the idea the FCC is seeking comment on is not currently technically feasible. For the incumbent LEC to gain the ability to measure terminating local interconnection minutes would require substantial investment in new measurement technology. In fact, the Washington UTC has found that the minimum cost of interconnection using the measurement technology is roughly three times the estimated minimum cost of providing local switching alone! Such an outcome is not acceptable for the long run, and even less desirable in terms of sunk costs for the interim.

Finally, the Washington UTC found that the usage sensitive pricing structure for switched access is inappropriate for local interconnection service in Washington because Washington State Law prohibits mandatory local measured service. In addition, the record in Washington is that consumers desire local, flat-rated calling. In regards to paragraph 142 where the NPRM suggests using an average usage factor, a geographically disaggregated usage factor, or some alternative methodology, in converting per-minute rates to flat rates or vice versa, the Washington UTC rejected such a conversion method in its interconnection case. To the extent that network element costs are driven by peak demand, rates should reflect that tendency. The Washington UTC has not ruled out the use of average usage factors in such models but would prefer to see structures that more accurately reflect peak, rather than average, demand.

In paragraph 151, the NPRM seeks comment on whether a capacity-based NTS rate or a traffic-sensitive (TS) rate may be efficient for recovering the cost of shared facilities in any given circumstance. As stated above, the Washington UTC has expressed a strong interest in flat rate port charges. As the NPRM notes, a flat rate based upon the cost of providing capacity at peak load is possibly the most economically correct pricing mechanism. Furthermore, off-peak usage then is at virtually zero cost.

In paragraph 157, the NPRM seeks comment on the meaning of specific terms of Section 251(d)(3). The Washington UTC has already made its position clear in its earlier statements regarding the meaning of this section.

H. Resale Obligations of Incumbent LECs NPRM ¶¶ 173-189).

The NPRM seeks comment in paragraph 173 regarding Section 251(c)(4). The Act clearly mandates that all LECs have a duty to not prohibit or to impose restrictions on the resale of their services and that incumbent LECs have the additional responsibility of offering their services at wholesale rates. The act correctly requires more of incumbent LECs than it does of new LECs because of the incumbent LECs' relative market power and the lack of incentive to offer their networks at wholesale rates. New LECs have every incentive to increase usage over their facilities whereas incumbent LECs view resale as lost market share and may not immediately embrace resale as a way of maximizing revenues in a competitive enviroment. The potential public benefits of an appropriately structured resale market are the creation of opportunities for new competitors and the consequent innovation in service and rate packages as well as in the efficient use of existing network facilities.

In regard to the setting of wholesale rates, the Washington UTC, in the U S West rate case, found rates for residential and business rates were set well above incremental cost, even when the cost of the loop was fully allocated to basic exchange service.[8] This finding, confirmed both by U S West cost studies and a proxy model, indicates that it is possible to set wholesale rates that are compensatory to the incumbent LEC.

Even with wholesale rates set at a compensatory level, most incumbent LECs will not see it being to their advantage to encourage resale of their local service. When a company is used to being the monopoly provider, it takes

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[8] The Washington UTC found that the cost of the local loop is not appropriately included in the incremental cost of local exchange service. It is a shared cost that should be recovered in the rates, but no one service is responsible for that recovery.

considerable vision on the part of the incumbent's leadership to view a competitor, who may ultimately help grow the market, as a positive occurence. The Washington UTC is uncertain when incumbent LECs will recognize the value of resale as a way of foreclosing uneconomic bypass and ensuring some contribution to their shared and common costs. Until that time arrives, the burden of proof should be upon the incumbent LEC to prove why a restriction it imposes is reasonable and nondiscriminatory.

With regard to discounted and promotional offerings (paragraph 175), we believe that if the incumbent LECs are allowed to offer these discounts, that they should cover appropriate costs, and be limited in duration, and that resellers and others should have the ability to make similar discounts. In no case should the incumbent LEC's promotion or discount be lower than the wholesale rate. Such an occurence should be considered below cost, potentially predatory pricing, and would likely have the effect of producing a price squeeze that competitors could not survive.

The Washington UTC supports resale pricing guidelines that prohibit predatory pricing without mandating specific rates or percentages. For competitive services, the Washington UTC requires incumbent LECs to produce imputation studies that establish price floors. This approach allows for flexible regulation within parameters. We also believe that incumbent LECs should bear the burden of proof when seeking to withdraw retail services, particularly if those services have the potential for resale.

In paragraph 176, the NPRM seeks comment on the Act's language "a State commission may, consistent with regulations prescribed by the Commission under this section, prohibit a reseller that obtains at wholesale rates a telecommunications service that is available at retail only to a category of subscribers from offering such service to a different category of subscribers." The Washington UTC, in an order requiring resale of unbundled loops, specifically prohibited the reselling of residential loop service as a business loop service. In the recent U S West rate case order (Docket UT-950200, Fifteenth Supplemental Order, attached as Appendix "B"), the Washington UTC set residential exchange service at the current state average of $10.50 per month and lowered the business exchange rate to $25.00 per month. Neither the company nor any other party proposed the same rate for residence and business. The Washington UTC found that both residential and business rates cover their costs and provide a contribution and that there are sufficient distinctions between these two categories to justify different rates. As long as such distinctions are made between classes of service, state commissions will need the ability to prevent resellers from taking advantage of arbitrage opportunities.

In paragraph 177, the NPRM invites comment on whether requiring new entrants to cope with resale policies that are inconsistent from one state to another would disadvantage them competitively. Earlier, we commented on how the FCC may not act to preclude enforcement of existing state requirements on the grounds that national uniformity is required. Still, there is merit to a minimum set of resale conditions that will allow competition to develop in a rational and appropriate manner. These conditions can include a list of the types of services that should be available for resale, specific prohibitions against resale restrictions that are inconsistent with the Act, and pricing guidelines which prevent predatory pricing but leave rate decisions to state commissions.

Paragraph 179 asks, "can and should we establish principles for the states to apply in order to determine wholesale prices in an expeditious and consistent manner?" The Washington UTC welcomes FCC principles which limit the range of conflict and deter or prevent continued litigation and other delaying tactics. Also, states should have the option (and not be required) to adopt federal pricing principles

The Washington UTC also believes that a set of pre-established uniform presumptions that states could adopt in the absence of LEC quantifications of retail related costs as explained in paragraph 181 would be a useful tool. States should be allowed to adopt the pre-established uniform presumption as an alternative to their own methods. But again, this should be voluntary on the part of the states, not mandatory.

The Washington UTC found the analysis in paragraph 183 illustrative of the difficulty in establishing a rigid federal pricing formula. California, after identifying costs attributable to retailing functions, established different percentage discounts for Pacific Bell and GTE. Illinois, when it completes its review, might very well also apply a different percentage discount. If every rate in every state were the same, it would make sense to apply a uniform standard. But they are not, as the experience in California demonstrates. LEC rates have evolved over time, through varying regulatory arrangements, settlements and service expansions. Establishing a wholesale rate that is fair, just and reasonable requires a review of contemporary costs and then applying that knowledge to the LEC's rate structure.

In paragraphs 184 through 188, the NPRM seeks comment on the relationship between rates for unbundled network elements and the rates for wholesale or retail service offerings. In particular, the NPRM seeks comment on the imputation rule. As LECs have become more diversified in their service and product offerings, the Washington UTC has increasingly used imputation as a method of ensuring that customers of monopoly services do not subsidize other more competitive services. Imputation also has been used to ensure that LEC competitors are not put into a price squeeze.

Although, imputation can be excruciatingly complicated at times, the Washington UTC has found it to be an essential tool in meeting its statutory obligation to prevent cross-subsidy and anticompetitive actions. There is nothing in the federal act nor is there a policy reason to prevent states from using imputation in the future. The concern raised by the NPRM regarding rates that are below cost has no bearing on the value of imputation. An imputation analysis will reveal if a retail rate puts a competitor into a price squeeze and may reveal that the rate is below cost. Such a discovery does not make imputation invalid but rather enhances its value as an essential regulatory tool during this transition.

The NPRM seeks comment on whether it would be appropriate to enter a preemption order requiring that rates for local service exceed the cost of providing that service (paragraph 188). First, the FCC cannot control local rates, Second, the Washington UTC is not sure if this is the proper rulemaking to deal with this. Finally, the Washington UTC believes the "threat" of below cost rates has been generally overstated. The Washington UTC declared in a policy paper two years ago that LEC rates should be set based on costs and as the NPRM notes, our recent review of U S West rates reveals that the existing average rate of $10.50 covers the company's incremental cost and a contribution to overhead.

Rather than approach this issue from the assumption that retail services are below cost and that an implicit subsidy exists, the FCC should look at how costs are determined and establish a definition of Total Service Long Run Incremental Cost.

I. Number Portability (NPRM ¶ 198).

The FCC has an obligation under the Act to establish a policy on service provider portability. The Washington UTC urges that while service provider portability is the immediate concern, that the FCC also consider whether location portability is also feasible and consistent with the policy it establishes.

Washington and several other states have set up task forces to explore different available solutions for number portability both for porting numbers between service providers and to other locations within a region. States that are currently involved in a number portability network model selection process recognize the need for a national solution and believe that an appropriate standard will evolve from this process.

J. Reciprocal Compensation for Transport and Termination of Traffic (NPRM ¶¶ 227-244).

In paragraph 227, the NPRM notes the Washington UTC has ordered incumbent LECs U S West and GTE-NW to file local interconnection service tariffs on a bill and keep basis for an interim period until flat rate port tariffs can be developed and put into effect. Since the issuance of the NPRM, the Washington

UTC has approved the "bill and keep" interconnection tariff filed by U S West. The Washington UTC also has ordered U S West and GTE to propose a flat rate capacity charge for interconnection no later than July 15, 1996. The Washington UTC asserts that this decision was valid under existing state and federal laws and remains so today.

In paragraph 243, the NPRM seeks comment on whether section 252(d)(2)(B)(1) authorizes states or the FCC to impose bill and keep arrangements. The Washington UTC strongly asserts that it does.

In addition, the FCC seeks comment on the meaning of the statutory description of bill and keep arrangements as "arrangements that waive mutual recovery." The Washington UTC found that each party in a bill and keep interconnection arrangement received value in return for the call termination services provided. Describing bill and keep as "arrangements that waive mutual recovery" is not accurate. Each party to a bill and keep agreement has obligations which are reciprocal.

In paragraph 244, the NPRM seeks comment on whether it might be desirable to establish an interim rule (such as bill and keep) to apply during a limited initial period while negotiations or arbitration proceedings are ongoing, and a different rule for states to use if called upon to establish long-term arbitrated rates. The Washington UTC's response is that bill and keep is the best alternative as an interim rule until a more cost-based, capacity-based rate structure can be developed.

III. CONCLUSION

The Washington UTC envisions a cooperative relationship between the FCC and the states in our efforts to establish conditions necessary for competition to develop. However, we believe that Section 2(b) of the 1934 Act and the provisions of the 1996 Act clearly preserve for the states the primary role in setting interconnection policy at the intrastate level. Given this clear limitation on FCC authority, the rules which the FCC adopts should be designed to provide broad guidelines and to reserve maximum flexibility to the states in implementation of the Act. The NPRM notes that a number of states, including Washington, have already started to address these issues. The decisions by these states should provide guidance to the FCC in establishing its rules. A cooperative approach will result in rules that further competition by fostering uniformity, limiting the range of conflict by clarifying the Act and providing states with broad guidelines that can be followed in implementing the Act.

DATED this 15th day of May, 1996, at Olympia, Washington.

Steve McLellan by

STEVE McLELLAN, Executive Secretary
Washington Utilities and Transportation Commission

SERVICE DATE
OCT 31 1995

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. U S WEST COMMUNICATIONS, INC., Respondent.	DOCKET NO. UT-941464
TCG SEATTLE and DIGITAL DIRECT OF SEATTLE, INC., Complainant, v. U S WEST COMMUNICATIONS, INC., Respondent.	DOCKET NO. UT-941465
TCG SEATTLE, Complainant, v. GTE NORTHWEST INCORPORATED, Respondent.	DOCKET NO. UT-950146
GTE NORTHWEST INCORPORATED, Third Party Complainant, v. U S WEST COMMUNICATIONS, INC. Third Party Respondent.	DOCKET NO. UT-950265
ELECTRIC LIGHTWAVE, INC., Complainant, v. GTE NORTHWEST INCORPORATED, Respondent.	FOURTH SUPPLEMENTAL ORDER REJECTING TARIFF FILINGS AND ORDERING REFILING; GRANTING COMPLAINTS, IN PART

APPENDIX A

SUMMARY

PROCEEDINGS: On November 14, 1994, in Docket No. UT-941464, U S WEST Communications, Inc. ("USWC"), filed certain tariff revisions described as integrated carrier access and interconnection designed to accommodate alternative local exchange companies, as well as those carriers that limit their service only to interexchange service. The revisions include a complete reissue and restructure of the access services tariff; the introduction of local interconnection service; the restructure of local transport service for switched access transport service, directory assistance transport service, and switched access common channel signaling access capability transport service; the introduction of expanded interconnection - collocation service in the private line transport services tariff, for all carriers; the introduction of switched access expanded interconnection service for all carriers; and the removal of intraLATA Feature Group A foreign exchange service from the Access Service tariff. The tariff revisions involve a complete restructure and replacement of the existing Access Service Tariff, WN U-25 (to be entirely replaced by a new tariff, WN U-30), and revisions to the Private Line Transport Services Tariff, WN U-22. The filing letter indicated that the total effect of the tariff revisions is revenue neutral. The stated effective date of the tariff revisions is January 1, 1995. On December 15, 1994, the Commission entered a complaint and order suspending the tariff revisions and instituting investigation.

On November 15, 1994, in Docket No. UT-941465, TCG Seattle ("TCG") and Digital Direct of Seattle, Inc. (since acquired by TCG Seattle), filed a complaint against USWC alleging undue prejudice, discrimination, and unjust rates and practices in the provision of interconnection and mutual compensation. USWC answered and counterclaimed. On February 13, 1995, the Commission consolidated Docket Nos. UT-941464 and UT-941465 for discovery and hearing.

On February 7, 1995, in Docket No. UT-950146, TCG filed a complaint against GTE Northwest Incorporated ("GTE") alleging undue prejudice, discrimination, and unjust rates and practices in the provision of interconnection and mutual compensation. GTE answered, counterclaimed against TCG, and filed a third party complaint against USWC.

On March 1, 1995, in Docket No. UT-950265, Electric Lightwave, Inc. ("ELI"), filed a complaint against GTE for undue prejudice, discrimination, and unjust rates and practices in the provision of interconnection and mutual compensation.

On March 8, 1995, the Commission consolidated Docket Nos. UT-950146 and UT-950265 with Docket Nos. UT-941464 and UT-941465.

HEARINGS: The Commission held hearings before Chairman Sharon L. Nelson, Commissioner Richard Hemstad, Commissioner William R. Gillis, and Administrative Law Judge Lisa A. Anderl of the Office of Administrative Hearings.

APPEARANCES: Respondent U S WEST Communications, Inc. ("USWC"), is represented by Edward T. Shaw, Molly K. Hastings, William O'Jile, and Douglas N. Owens, attorneys, Seattle. The Staff of the Washington Utilities and Transportation Commission ("Commission Staff") is represented by Steven W. Smith and Gregory Trautman, assistant attorneys general, Olympia. The public is represented by Donald T. Trotter, assistant attorney general, Public Counsel Section, Seattle ("Public Counsel"). Complainant/intervenor TCG Seattle ("TCG") is represented by Daniel Waggoner and Gregory J. Kopta, attorneys, Seattle. Complainant/intervenor Electric Lightwave, Inc. ("ELI"), is represented by Arthur A. Butler, attorney, Seattle, and by Ellen Deutsch, attorney, Vancouver. The following intervenors appeared: Washington Independent Telephone Association ("WITA"), represented by Richard A. Finnegan, attorney, Tacoma; AT&T, represented by Susan D. Proctor and Rick D. Bailey, attorneys, Denver, Colorado; Interexchange Access Coalition ("IAC"), represented by Brad Mutschelknaus and Edward A. Yorkgitis, Jr., attorneys, Washington, D.C.; GTE Northwest, Inc. ("GTE"), represented by Richard Potter, attorney, Everett; MCI, represented by Sue E. Weiske, attorney, Denver, and MCI/MCI Metro by Clyde H. MacIver, attorney, Seattle; Sprint, represented by Lesla Lehtonen, attorney, San Mateo, California; Tenino Telephone Company and Kalama Telephone Company, represented by Richard Snyder, attorney, Seattle; United Telephone, represented by Seth Lubin, attorney, Hood River, Oregon; MFS Intelenet of Washington, Inc., ("MFS") represented by Andrew D. Lipman, Richard M. Rindler, and Charles H.N. Kallenbach, attorneys, Washington, D.C.; TRACER, represented by Stephen J. Kennedy, attorney, Seattle; and the Department of Defense/Federal Executive Agencies ("DOD/FEA"), represented by Robert A. Ganton, attorney, Arlington, Virginia.

COMMISSION: USWC did not establish its proposed tariff revisions to be fair, just, reasonable, and sufficient. The Commission rejects the cost studies and tariff revisions submitted by USWC in support of its reissue and restructure of the Access Service Tariff, WN-25, and its revisions to the Private Line Transport Services Tariff, WN U-22. The Commission orders USWC to refile tariff revisions. The Commission's decisions on the tariff filing appear to resolve all issues raised in TCG's complaint. The Commission grants the complaints of TCG and ELI against GTE, in part. The local interconnection terms that GTE has offered the complainants, based on a minutes of use structure, are not fair, just, and reasonable, are anticompetitive, subject the complainants to unreasonable prejudice or disadvantage, and are discriminatory. The Commission orders GTE to interconnect with TCG and ELI on the same terms and conditions as it interconnects with USWC and other incumbent LECs, including, on a transitional basis, terminating the local traffic (including EAS) of TCG and ELI on a bill and keep basis. The Commission orders GTE to file a local interconnection tariff pursuant to the terms of this order. The Commission dismisses the counterclaims of USWC and GTE, and dismisses the third party complaint of GTE.

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MEMORANDUM

I. SCOPE OF PROCEEDINGS

The Commission faces many difficult issues as it attempts to facilitate the transition of the telecommunications industry from a monopoly market structure to a competitive market structure. One set of issues, before us in this proceeding, relates to the terms and conditions under which competitors for local exchange service will interconnect their networks so that they can exchange traffic between their customers.

Before discussing the issues in this proceeding, we will review some of the basic terminology involved in telecommunications, and provide a brief background on the development of local service competition.

A. TERMINOLOGY

Exchange. The local telephone exchange is the basic unit in the structure of telephone service in Washington. The Commission defines an exchange as "a unit established by a utility for communication service in a specific geographic area, which unit usually embraces a city, town or community and its environs. It usually consists of one or more central offices together with the associated plant used in furnishing communication service to the general public within that area." WAC 480-120-021. The exchange originated in the early development of telephone service, when it constituted the area served by a single telephone company central office, where the manual switchboard, attended by an operator, was housed.

Local Exchange Company ("LEC"). Each exchange historically has been served by a single local exchange company (LEC). USWC and GTE are the largest LECs in Washington. A LEC provides local calling service (calls that originate and terminate within a local service area) and a range of other telecommunications services.

Flat-rated Local Service. The rates for basic local exchange service in this state are set on a flat-rate pricing system; extended area service rate additives may include both a flat-rate and a measured rate component option. The Washington Legislature has declared that "[t]he implementation of mandatory local measured telecommunications service is a major policy change in available telecommunications service." RCW 80.04.130 The Commission is prohibited from accepting or approving a tariff filing which imposes mandatory local measured service on any customer or class of customers prior to June 1, 1998, except for EAS or foreign exchange service.

Interexchange Carriers ("IXCs"); Access Charges. Service between exchanges ("interexchange service") is provided by LECs (to a limited extent)[1], and by companies that exclusively provide interexchange service, such as AT&T, MCI, and Sprint.[2] Any company providing interexchange service is an "interexchange carrier" or "IXC", although that term generally has been used to refer only to long distance companies that have been exclusively interexchange service providers. An interexchange call generally is a "toll" call, for which the customer originating the call may be charged a distance and/or time sensitive rate.

When a call between two exchanges (an "interexchange call") involves more than one telecommunications company, the IXC that carries the call generally compensates the LEC for providing the local link(s) to the end user(s). LECs provide a tariffed "access service" for the local link. For example, if AT&T is carrying a call that originates in a GTE-NW exchange and terminates in a USWC exchange, AT&T will be assessed access charges for both the originating and the terminating local links. Access charges historically have been a very large portion of an IXC's total cost of doing business.

Extended Area Service ("EAS"). Some interexchange calls are not toll calls for the originating customer. The Commission, pursuant to procedures set out in RCW 80.36.855 and WAC 480-120-400, has designated certain clusters of adjoining exchanges for which there is a high volume of interexchange traffic as extended area service (EAS) territories for which interexchange calling is toll-free to the caller. EAS thus is an enlarged local calling area. For most customers with EAS, an "EAS additive" is rolled into their monthly rate for basic local service, to compensate the LEC for the toll revenue it lost when the Commission ordered EAS for the territory.

Some EAS territories involve more than one LEC. For most EAS areas, incumbent LECs have agreed not to charge one another access charges for completing EAS traffic. Instead, they have exchanged EAS traffic on a bill and keep basis. Each LEC bills its own

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[1] When the American Telephone and Telegraph Company (AT&T) was broken up in the early 1980s, the provision of cross-country long distance service was separated from the provision of local service. By the terms of the court order, the "Baby Bells" that were assigned local service were restricted to providing intraexchange service and interexchange service within a Local Access and Transport Area (LATA), which is a geographic area consisting of many exchanges. This Commission authorized USWC to provide interexchange, intraLATA service statewide, and more recently authorized GTE to provide such service in most of western Washington. Exclusively interexchange companies ("IXCs"), such as AT&T, MCI, and Sprint, provide service between LATAs, and also are allowed to compete in providing intraLATA, interexchange service.

[2] Even this distinction is now blurring as AT&T has undertaken provision of local service as a cellular provider; MCI has formed "MCI Metro," which has been authorized to provide basic local exchange service in this state; and Sprint has entered into partnership arrangements to pursue local telephony with cable television providers.

customers the EAS additive and keeps the revenue rather than sharing it with the other companies involved. Commission rules now require that intercompany EAS be on a bill and keep basis.

Central Office; End Office; Customer Loop; Tandem Switch. See "Exchange," above. Telephone company switching offices continue to be referred to as "central offices" (or as "wire centers"). A single exchange may have numerous central offices, depending on the number of customers served. A central office also is referred to by other terms that reflect its various functions. A central office that is the first switching point in the network from the end user's perspective commonly is referred to as an "end office." Usually, each customer is connected to the end office switch by means of a twisted pair of copper wires, called the "customer loop".

End offices are connected to one another by trunk lines and/or via a tandem switch. A tandem switch is the largest aggregation point in the network, a switching facility that interconnects trunk lines from the LEC's end offices and lines from other telecommunications companies. A tandem thus is an intermediate switch between the originating call location and the final location. Utilizing a tandem eliminates the need to directly connect all end offices to one another.

Point of Presence; Meet Points. IXCs and incumbent LECs that share EAS territories have interconnected with one another for years. IXCs generally interconnect with the LEC's network at a "point of presence", usually the IXC's central office location.

Incumbent LECs generally interconnect with one another at mutually agreed upon "meet points," such as a manhole on the boundary between their service territories, using relatively simple methods such as the splicing together of trunks.

Alternative Local Exchange Companies ("ALECs"). New competitors of historical LECs in the local exchange service market, as described in the background below, are called by various names. In addition to "ALECs," they are referred to as "alternative exchange carriers" ("AECs"), "competitive local exchange companies" ("CLECs"), and "new LECs."

B. BACKGROUND

In 1985, the Washington Legislature declared it the policy of the state to "promote diversity in the supply of telecommunications services and products in telecommunications markets throughout the state." RCW 80.36.300. However, until 1993, a divided Commission interpreted its statutes as providing for quasi-exclusive local service territories. A Superior Court decision in November 1992[3] caused the Commission majority to change its

[3] On November 13, 1992, the Superior Court of the State of Washington for King County entered a decision which reversed a Commission decision that LECs had quasi-exclusive rights to provide service in an exchange area under RCW 80.36.230.